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SUBJECT: EDRC REVIEW OF SWEDEN APRIL 14

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1. SUMMARY. SECRETARIAT SEES SIGNIFICANT WEAKENING IN 1975 OF RECENT BOOM CONDITIONS, AS BOTH DOMESTIC AND FOREIGN DEMAND COMPONENTS ARE EXPECTED TO ADVANCE AT SLOWER RATE. AT SAME TIME, SOME ACCELERATION IN PRICE AND WAGE INCREASE CAN BE EXPECTED, AND CURRENT BALANCE OF PAYMENTS IS LIKELY TO SHOW FURTHER DETERIORATION. DESPITE WEAKENING ACTIVITY, NO SUBSTANTIAL RISE IN UNEMPLOYMENT IS FORESEEN. MAIN ISSUES FOR DISCUSSION WILL FOCUS ON PROSPECTIVE DEVELOPMENTS IN 1975, MEASURES TO COMBAT INFLATION, AND MEASURES TO MAINTAIN EMPLOYMENT. END SUMMARY.

2. GENERAL ECONOMIC OUTLOOK: SECRETARIAT NOTES THAT PERFORMANCE OF SWEDISH ECONOMY IN TERMS OF REAL GROWTH

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AND RELATIVE PRICE AND WAGE STABILITY HAS BEEN "QUITE

IMPRESSIVE" DURING PAST YEAR, PARTICULARLY WHEN VIEWED AGAINST INTERNATIONAL TRENDS. HOWEVER, 1975 OUTLOOK IS FOR MUCH WEAKER DEMAND CONDITIONS, CONTINUED RELATIVELY HIGH DEFICIT ON CURRENT ACCOUNT AND AN ACCELERATION OF INFLATION. SECRETARIAT DIFFERS SIGNIFICANTLY FROM SWEDISH AUTHORITIES IN FORECASTING LIKELY GROWTH OF REAL OUTPUT, WITH SECRETARIAT FORECASTING 1 PERCENT REAL INCREASE IN GDP, AND SWEDES PROJECTING 2.5 PERCENT INCREASE. DIFFERENCE BETWEEN TWO IS LARGELY ATTRIBUTABLE TO SECRETARIAT'S LESS OPTIMISTIC EXPECTATIONS FOR FOREIGN TRADE AND FOR MOST MAJOR DOMESTIC DEMAND COMPONENTS.

3. POLICY RECOMMENDATIONS: SECRETARIAT FORECAST OF WEAKENING DEMAND CONDITIONS LEADS IT TO SUGGEST THAT ADDITIONAL MEASURES MAY BE NECESSARY TO STIMULATE DEMAND, BUT FOR THE MOMENT IT WOULD BE PREFERABLE TO WAIT UNTIL CLEARER PICTURE CAN BE OBTAINED OF EXTENT OF PROSPECTIVE SLOWDOWN. SECRETARIAT SUGGESTS THAT CUTS IN PERSONAL INCOME TAX MIGHT HELP TO REDUCE DANGER OF INFLATIONARY WAGE SETTLEMENTS, WHILE COST-REDUCING FISCAL MEASURES MIGHT ALSO HELP TO RESTRAIN WAGE-PRICE SPIRAL.

4. BALANCE OF PAYMENTS: SECRETARIAT CONSIDERS BALANCE OF PAYMENTS TO BE MAJOR RESTRAINT ON ECONOMIC POLICY-MAKING IN VIEW OF FACT THAT CURRENT ACCOUNT DETERIORATION IN 1974 WAS NOT ACCOMPANIED BY STRENGTHENING OF LONG-TERM CAPITAL ACCOUNT. OFFICIAL FOREIGN EXCHANGE RESERVES DROPPED BY 30 PERCENT IN 1974 TO LESS THAN ONE MONTH'S CURRENT IMPORTS. GIVEN RECESSIONARY TENDENCIES ABROAD, PROSPECTS FOR REDUCTION IN CURRENT DEFICIT IN 1975 ARE SMALL. SECRETARIAT SUGGESTS THAT TO PREVENT FURTHER DRAIN ON EXTERNAL RESERVES IT MAY BE NECESSARY TO MAINTAIN RELATIVELY TIGHT STANCE OF MONETARY POLICY AND FINANCE PART OF PUBLIC SECTOR DEFICIT THROUGH CAPITAL IMPORTS. IN PARTICULAR, IT WOULD BE DESIRABLE TO HAVE HIGHER DOMESTIC INTEREST RATES AS AN INDUCEMENT TO PRIVATE BORROWING ABROAD.

5. MISSION WOULD APPRECIATE ANY SUGGESTIONS AS TO ADDITIONAL QUESTIONS THAT MIGHT BE RAISED AT ANNUAL LIMITED OFFICIAL USE

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